

Warsaw, 26 April 2006

INFORMATION FROM THE MEETING OF THE MONETARY POLICY COUNCIL

held on 25-26 April 2006

The Council decided to keep the NBP interest rates unchanged, i.e.:

reference rate 4.00% on an annual basis;

lombard rate 5.50% on an annual basis;

deposit rate 2.50% on an annual basis;

rediscount rate 4.25% on an annual basis.

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Since the Council's meeting in March 2006, the forecasts of economic growth in the euro area and the United States for 2006 have been slightly revised upwards. Besides, in the United States the 2006 inflation forecasts have been slightly raised while in the euro area the 2006 inflation forecasts have been slightly lowered. In March 2006 the annual growth of consumer prices in the euro area decreased to 2.2% from 2.3% recorded in February, and in the United States to 3.4% from 3.6% respectively. Since the March meeting of the Council, oil prices climbed, hitting the highest level in history (Brent oil price rose by USD 9.9 per barrel, i.e. by 15.3%). March was another consecutive month which saw the rise in the average price of this commodity as forecasted for 2006 by analysts in the Reuters survey (by 5.2% as compared to the previous month's forecasts). Still, uncertainty persists as to the effect of the increase in oil prices on economic growth and inflation.

The upward trend in the annual growth rate of industrial output observed for the last eight months points to a strengthening recovery in industry, in particular in manufacturing. In March 2006 the growth of industrial output largely exceeded the expectations of the majority of external forecasters and the NBP, and amounted to 16.4% y/y i.e. the highest level since April 2004. In seasonally adjusted terms, growth in industrial output in March amounted to 13.6% y/y as compared to 9.8% y/y in February 2006. After falling for two months mainly as a result of unfavourable weather conditions, March saw a strong rise in the construction and assembly output (15.5% y/y as compared with -3.5% y/y in February, and 8.3% y/y as compared with 0.6% y/y in seasonally adjusted terms). The rise in retail sales was larger than expected and amounted to 10.1% y/y in nominal terms. Lending to households has continued on an upward trend: consumer loans registered an increase of 18.9% y/y in March (compared with 19.3% y/y in February), while the growth rate of housing loans stepped up to 45.9% y/y (compared with 42.6% y/y in February). The growth of corporate lending remains moderate (an increase of 3.8% y/y in March against 4.7% y/y in February). The growth in lending to enterprises may be limited by the fact that enterprises hold considerable own funds in connection with their good financial results in 2005.

The accelerating economic growth increases the demand for labour. Since December 2004 the growth of employment in the corporate sector has been accelerating. In March employment in enterprises was 2.7% higher than a year before (as compared with a rise of 2.5% y/y in February).

March saw a continued fall in unemployment in annual terms (down to 17.8% from 19.2% recorded a year before).

The economic recovery is accompanied by acceleration of wage growth. In March the wage growth in the corporate sector stepped up to 5.4% y/y (against 4.8% y/y in February). A necessary condition of sustainable acceleration of economic growth not threatening the achievement of the inflation target is to ensure that in the long run wages do not grow faster than labour productivity.

The annual consumer price growth in March fell to 0.4%. The drop in the inflation rate in March 2006 in relation to February was driven by a fall in food and non-alcoholic beverage prices, a slight drop in fuel prices and the fading out of the statistical base effect occurring in the case of the internet services prices. In March 2005 the prices of internet services increased considerably following the introduction of the VAT on those services.

Core inflation indicators remained low (in March they ranged between -0.6% y/y and 0.7% y/y). The low level of all core inflation indices confirms continuation of low inflationary pressure. In April, inflation expectations of households remained low (0.6%, i.e. exactly the same as in the previous month).

March 2006 saw an increase in annual growth of producer prices in industry up to 0.9% y/y as compared to 0.7% y/y in February (0.7% m/m in March against -0.1% in February). Such a month-on-month rise of producer prices was last observed in April 2005. The increase in the annual growth of PPI occurred even though the effective exchange rate of the zloty was stronger than a year before.

In line with the NBP inflation projection presented in the April *Inflation Report*, the annual GDP growth will be with 50% probability within the range of 3.9-5.0% in 2006 (as compared with 3.8-5.1% in the January projection); 3.4-5.8% in 2007 (as compared with 3.4-5.2%) and 3.5-6.2% in 2008 (as compared with 3.6-5.5%).

The April inflation projection indicates that the growth rate of consumer prices is likely to be slightly lower in 2006, similar in 2007, but in 2008 slightly higher than that expected in the January *Report*. Under constant interest rates, with 50% probability inflation will be within the range of 0.5-2.0% in 2006 Q4 (as compared with 0.5-2.3% in the January projection), 1.3-3.4% in 2007 Q4 (as compared with 1.1-3.6%) and 1.2-3.9% in 2008 Q4 (as compared with 0.8-3.9%).

It should be emphasised that the inflation projection presented in the *Report* does not account for all sources of uncertainty. This primarily applies to the scale of the future impact of globalisation on inflation, the growth of workforce, the direction of economic policy in the coming years and the exchange rate developments. Besides, the projection was prepared on the basis of data available until 24 March 2006 and thus does not account for crude oil and fuel prices, which are considerably higher than those assumed in the projection, higher estimates of GDP and wages in the economy in 2006 Q1 and slightly lower than forecasted CPI in 2006 Q1. However, "net" inflation in 2006 Q1 was consistent with the April projection.

The Council maintains its assessment that with large probability inflation will in 2006 Q2 and maybe Q3 remain below the inflation target mainly due to short-term factors. If the developments in the economy were consistent with the April NBP inflation projection, then the current level of the reference rate of the central bank would support a gradual return of inflation to the target over the projection horizon and would also be conducive to keeping economic growth at a pace, which is consistent with the potential output growth, determined by the structural features of the Polish economy.

The fact that inflation and core inflation has stayed below the previous forecasts for a relatively long period may be an indication that the impact of the factors which may slow down the returning of inflation to the target in relation to that accounted for in the projection is stronger than previously assumed. Factors which could potentially accelerate the return of inflation back to the target include a higher wage growth than assumed in the projection, provided it would not be

NBP

accompanied by sufficiently fast increase of productivity, further oil price hikes or a deterioration of the public finance situation in relation to that envisaged in the *Convergence Programme*.

The Council maintains its belief that the most favourable scenario for Poland would be to implement an economic strategy focused on creating conditions which would ensure the introduction of the euro at the earliest possible date, which would be conducive to a higher long-term economic growth.

The Council also approved the *Financial Report of the National Bank of Poland prepared as of 31 December 2005, Balance of Payments of the Republic of Poland for 2005 Q4* and the *April Inflation Report*.

The next meeting of the Council will be held on 18 May 2006 and will focus on the draft *Report on the implementation of monetary policy guidelines in 2005*. The *Report* will be finally approved at the Council's meeting held on 30-31 May 2006.